2001

First Equity Corporation v. Utah State University and Donald A. Carlton : Brief of Appellant

Utah Supreme Court

Vernon B. Romney; Attorney Genreral; David L Wilkinson; Attorney for Respondent.
Johnson and Spackman; Attorneys for Appellant.

IN THE SUPREME COURT OF

THE STATE OF UTAH

FIRST EQUITY CORPORATION, a Florida corporation, Plaintiff - Appellant, vs. UTAH STATE UNIVERSITY, a body politic and corporate, Defendant - Respondent, and DONALD A. CATRON, an individual, Defendant.	CASE NO. 13798

APPELLANT'S BRIEF

Appeal from Summary Judgment in the First Judicial District Court for Cache County, State of Utah, the Honorable VeNoy Christofferson, Presiding.

JOHNSON & SPACKMAN
1320 Continental Bank Building
Salt Lake City, Utah 84101
Attorneys for Plaintiff - Appellant

VERNON B. ROMNEY
Attorney General
DAVID L. WILKINSON
Special Trial Counsel
236 State Capitol Building
Salt Lake City, Utah 84114
Attorneys for Defendant -
Respondent Utah State University

IN THE SUPREME COURT OF

THE STATE OF UTAH

FIRST EQUITY CORPORATION, a Florida corporation, Plaintiff - Appellant, vs. UTAH STATE UNIVERSITY, a body politic and corporate, Defendant - Respondent, and DONALD A. CATRON, an individual, Defendant.	CASE NO. 13798

APPELLANT'S BRIEF

Appeal from Summary Judgment in the First Judicial District Court for Cache County, State of Utah, the Honorable VeNoy Christofferson, Presiding.

JOHNSON & SPACKMAN
1320 Continental Bank Building
Salt Lake City, Utah 84101
Attorneys for Plaintiff - Appellant

VERNON B. ROMNEY
Attorney General
DAVID L. WILKINSON
Special Trial Counsel
236 State Capitol Building
Salt Lake City, Utah 84114
Attorneys for Defendant -
Respondent Utah State University

TABLE OF CONTENTS

INDEX OF CASES AND AUTHORITIES CITED

Constitution, Statutes, and Regulations

Authorities

IN THE SUPREME COURT OF

THE STATE OF UTAH

FIRST EQUITY CORPORATION, a Florida corporation, Appellant, vs. UTAH STATE UNIVERSITY, a body politic and corporate, and DONALD A. CATRON, an individual, Respondents.	CASE NO. 13798

APPELLANT'S BRIEF

NATURE OF THE CASE

This is a damage action brought by a registered securities broker, First Equity Corporation ("First Equity"), a Florida corporation, against Donald A. Catron ("Catron"), formerly the Assistant Vice President of Finance of Utah State University, and against Utah State University ("USU"), seeking recovery of commissions and other monies lost by First Equity as a direct consequence of USU's refusal to accept certain shares ordered by Catron at a time when he was Assistant Vice President of Finance.

DISPOSITION IN LOWER COURT

After substantial pleading, amendments to pleadings, and discovery, First Equity and USU filed opposing motions for summary judgment which were argued before the Lower Court. The Court granted summary judgment in favor of USU and denied summary judgment in favor of First Equity. Catron's defenses and counterclaims were not involved in the opposing motions below, nor are they involved in this appeal.

RELIEF SOUGHT ON APPEAL

Appellant seeks reversal of the summary judgment of the Lower Court and judgment in its favor against USU.

STATEMENT OF FACTS

1. USU AUTHORIZED CATRON TO PURCHASE SECURITIES OF ANY KIND THROUGH ANY BROKER WHO WAS A MEMBER OF ANY MAJOR SECURITIES EXCHANGE OR THE NATIONAL ASSOCIATION OF SECURITIES DEALERS.

USU is a corporate body politic whose rights and powers are perpetuated by the Constitution of the State of Utah. (Record [hereinafter cited as "R."] at 203). Catron was employed by USU on March 16, 1970, as a consultant to the retiring Controller. (R. 29, 194, 200; Deposition of Catron [hereinafter cited as "D."], at 9). From July 1, 1970 until approximately January, 1972, Catron served as Controller of USU. (R. 194-196, 212; D. 9-10).

While he was thus serving, the USU Institutional Council, a council organized pursuant to 5B Utah Code Annotated §53-48-19 (1953) (hereinafter cited as "U.C.A."), adopted a formal investment policy establishing an Investment Committee and providing for the appointment of Catron as "the University money manager with authority to make investment decisions in keeping with established policies and submit reports of performance and portfolio investments at least monthly to the Investment Committee and quarterly to the Institutional Council." (R. 309, 314-16). This policy was adopted on June 26, 1971, and represented only one of five different resolutions containing similar authorizations for Catron to invest the funds of USU. (R. 151). On January 20, 1972, the Institutional Council approved a corporate resolution authorizing Dee A. Broadbent, ("Broadbent"), Vice President for Business and Treasurer of USU, or Catron to act for USU in opening and maintaining:

> . . . an account with any broker who is a member of any of the major security exchanges or the National Association of Security [sic] Dealers for the purchase, trade, and sale, long or short, transfer, and assign [sic], stocks, bonds, and securities of every nature on margin or otherwise, and that any of the officers hereinafter named be, and hereby is authorized to give written or verbal instruction to the brokers concerning the herein

named transactions; and he shall at all times have authority in every way to bind and obligate this corporation for the carrying out of any contract or transaction which shall, for or on behalf of this corporation, be entered into or made with or through the brokers; and that the brokers are authorized to receive from this corporation, checks and drafts drawn upon the funds of this corporation by any officer or employee of this corporation, and to apply the same to the credit of this corporation or to its account with said brokers: All confirmations, notices, and demands upon this corporation may be delivered by the brokers verbally or in writing, or by telegraph, or by telephone to any such officer and he is authorized to empower any person, or persons, that he deems proper, at any time, or times, to do any and all things that he is hereinbefore authorized to do. That this resolution shall be and remain in full force and effect until written notice of the revocation hereof shall be delivered to the brokers. [Emphasis added].

(R. 106, 137-38, 161-62).

2. PURSUANT TO HIS AUTHORITY, CATRON OPENED A SPECIAL CASH ACCOUNT WITH FIRST EQUITY, A MEMBER OF THE NATIONAL ASSOCIATION OF SECURITIES DEALERS, AND THROUGH THAT ACCOUNT, CATRON ORDERED AND USU RECEIVED, ACCEPTED, AND PAID FOR CERTAIN SECURITIES.

During the Winter of 1971-72 and while acting in his capacity as "University money manager", Catron attended a Florida investment seminar sponsored by First Equity, a securities broker registered with the National Association of Securities Dealers. (R. 412; D. 21-23, 78-79). Catron attended a similar seminar sponsored by First Equity in approximately September, 1972.

(D. 79-80, 93-95). At these seminars, Catron met the officers and agents of First Equity and was identified to them as the "investment officer" at USU. His expenses were paid by USU. (D. 22-23, 78-80). Shortly after the second seminar, Catron began purchasing shares on behalf of USU through a special cash account with First Equity. (R. 275, 298, 303; D. 93).

Although evidence with respect to the opening of the account with First Equity is inconclusive as to the procedure followed in that instance, the decision to open such an account was generally transmitted by telephone to the broker. (D. 81). Catron presumed that his secretary or one of the part-time girls would send authorizing resolutions to all of the brokerage firms because that was standard procedure. (D. 74-77, 82-84). Although Marcia Ann Beazer, Catron's secretary, did not think that it was "standard procedure" to send out a copy of the January 20, 1972 corporate resolution to every broker, she conceded that it was "possible" that she had sent a copy of the resolution to First Equity. (R. 321). In any case, Catron indicated that he discussed his authority over the telephone with the broker and he considered it a "mechanical" matter to send the form. (D. 74-75).

Between October 27, 1972, and February 28, 1973, Catron ordered by telephone the purchase of the following corporate

securities through First Equity:

Trade Date	Company Name	Number of Shares	Price	Broker's Commission
10-27-72	Cunningham Arts	11,000	$129,437.50	$1,119.75
12-22-72	Hughes Tool Co.	2,000	82.937.50	---
1-8-73	Fashion Fabrics	3,100	46,350.00	471.51
1-9-73	Fashion Fabrics	1,900	28,925.00	351.55
1-12-73	Fashion Fabrics	5,000	69,925.00	641.70
*1-17-73	Advanced Memory Systems	5,000	111,250.00	807.00
1-23-73	A.T. & T. Co.	2,000	105,000.00	662.00
1-23-73	Ford Motor Co.	2,000	148,750.00	837.00
1-23-75	Taft Broadcasting Co.	2,000	95,787.50	621.15
*1-31-73	Panelrama	24,100	289,200.00	2,282.80
1-31-73	Levitz Furniture Corp.	9,000	192,375.00	1,291.50
1-31-73	National General	5,000	166,250.00	1,027.00
1-31-73	Health Industries	15,000	58,125.00	994.50
*2-28-73	Great Basins Petroleum	83,000	251,400.00	4,519.60
*2-28-73	Computing & Softwares	55,700	563,962.50	3,654.05
*2-28-73	Natomas Co.	13,000	728,000.00	2,677.70
2-28-73	Fashion Fabrics	51,600	445,050.00	3,423.15

(R. 99-149, 160-62; D. 80-81). First Equity delivered certificates for all of the shares listed above, except for those orders marked by an asterisk, and USU received, accepted, and paid for them in

full, including applicable commissions. (R. 1-20, 99-149, 160-62, 164).

3. CATRON ORDERED SECURITIES THROUGH FIRST EQUITY, A FLORIDA BROKER, BECAUSE ITS DELIVERY TIME WAS SLOWER THAN OTHER BROKERS AND, THEREFORE, USU WAS ABLE TO KEEP AND USE ITS FUNDS FOR A LONGER PERIOD OF TIME.

On October 27, 1972, Catron placed an order with First Equity to purchase 11,000 shares of Cunningham Arts on behalf of USU and he instructed First Equity to make delivery against payment at the First Security Bank in Logan, Utah. (R. 99-149, 160-62, 312-13). First Equity purchased the shares on behalf of USU and caused certificates to be delivered to First Security Bank. A representative of the bank informed USU that the certificates had arrived and delivered them to USU upon receipt of a check for the price of the stock made payable to the bank. (R. 312-13). Payment for all of the 11,000 shares was not completed by USU until December 5, 1972, approximately thirty-nine days after the order was placed. (R. 303).

When Catron became acquainted with the delays which were involved in obtaining delivery from and making payment to First Equity, he increased his use of the brokerage firm. He considered the longer time periods a distinct advantage to USU because the university could keep and use its funds for a longer period of time. (D. 118-19, 218-21).

4. ON MARCH 19, 1973, USU REFUSED TO ACCEPT DELIVERY OF CERTAIN SECURITIES, WHICH HAD BEEN ORDERED BY CATRON ON BEHALF OF USU, ON THE GROUNDS THAT CATRON HAD NO AUTHORITY TO ORDER THEM.

Five of USU's orders, each of which is marked on the above list by an asterisk, were not accepted by USU. On March 13, 1973, First Equity tendered delivery to USU of 3,000 shares of Advanced Memory Systems, but USU refused payment. (R. 305, 307, 313). At approximately the same time, delivery was tendered to USU of sufficient shares to satisfy the other four outstanding orders. (R. 313, 342). On March 19, 1973, First Equity was informed by USU that the university would not accept delivery with respect to all five orders on the grounds that Catron was not authorized to purchase securities on behalf of USU. (R. 196, 251). Written confirmation of this was given to First Equity's Salt Lake City attorney on March 22, 1973, by hand delivered letter from Assistant Attorney General Mark A. Madsen ("Madsen"). (R. 330-31).

5. NOTICE OF A SECRET TERMINATION OF CATRON'S AUTHORITY TO PURCHASE SECURITIES ON BEHALF OF USU WAS NOT GIVEN TO FIRST EQUITY UNTIL AFTER FEBRUARY 28, 1973.

Catron was appointed "University money manager" by the USU Institutional Council on or about June 26, 1971, and he continued to carry out the duties of that position until March 20, 1973, when he was officially suspended. (R. 196, 212-13).

As the investment officer of USU, Catron was invested with "authority to make investment decisions in keeping with established policies". (R. 309, 314-16). The policy statement adopted by the Institutional Council at the time Catron was appointed gave him authority for the following three years (until June 26, 1974) to "reinvest" up to sixty percent (60%) of the funds that were not needed for current purposes "to build up the investment pool for long range objectives." (R. 315-16).

Approximately six months later, the Institutional Council further authorized Catron and Broadbent, Catron's immediate superior, to establish accounts with registered brokers for the purchase of "stocks, bonds, and securities of every nature on margin or otherwise". The authorization was to "remain in full force and effect until written notice [of a revocation was] delivered to the brokers." (R. 106, 137-38, 161-62).

First Equity received no notice of revocation until so informed by telephone on March 19, 1973, and received no written notice of revocation until March 22, 1973. (R. 196, 251, 330-31). Thus, Catron's investment duties and authority were officially suspended and notice of the revocation of his authority was given to First Equity some three weeks after February 28, 1973.

USU claims that Catron's authority to purchase common stock was revoked beginning around December 4, 1972. (R. 152, 203, 359).

Whether or not this is true has no bearing on this appeal. USU continued to receive, accept, pay for, and enjoy the benefits of owning common stock ordered by Catron on behalf of USU until after February 28, 1973. Every order placed with First Equity, other than the first one, was communicated to First Equity on or after December 22, 1972. (R. 99-149, 160-62, 164). As shown by the list of orders set forth hereinabove, USU received, accepted and paid for $1,356,537.50 in common stock after the alleged secret revocation. Indeed, the February 28, 1973 order for 51,600 shares of Fashion Fabrics was received, accepted, and paid for in full in the amount of $445,050.00 plus broker's commissions in early March, 1973, approximately three months after the alleged secret revocation. (R. 99-149, 160-62).

6. FIRST EQUITY SUFFERED MONETARY DAMAGES AS A RESULT OF USU'S REFUSAL TO ACCEPT DELIVERY OF CERTAIN SECURITIES.

After USU's refusal to accept delivery of the orders marked by asterisks in the above list, First Equity and others effected a cancellation of the transactions involved with respect to these orders, except that of Advanced Memory Systems shares. (R. 329, 350-51). As a result of USU's refusal to accept delivery of all five orders, First Equity lost brokerage commissions in the amount of $13,941.15. (R. 425). As a result of USU's refusal

to accept delivery of Advanced Memory Systems shares, First Equity suffered losses on the sale of those shares in the amount of $37,045.27. (R. 248-49).

Upon USU's refusal to pay for the losses incurred by First Equity as a result of USU's refusal to accept the shares, First Equity filed a Complaint in the District Court of Cache County, Utah, naming USU and Catron as the parties responsible for the losses and seeking recovery of damages. (R. 1-20). Cross Motions for Summary Judgment were made by USU and First Equity based upon the allegations in the Complaint. (R. 238-39, 433-34). No motion was filed by Catron.

Summary Judgment in favor of the university was granted on the ground the 4A U.C.A. §33-1-1 prohibited USU from investing any funds in common stock and, therefore, First Equity's Complaint failed to state a claim for relief which could be granted. (R. 435D). First Equity's Motion for Summary Judgment was denied on the grounds that (1) USU had no statutory power to invest public funds in common stock, (2) a triable issue of fact existed as to whether non-public funds were available to purchase the common stock, and (3) Regulation T, promulgated by the Federal Reserve Board under the authority of the Securities Exchange Act of 1934, constituted

a complete defense as to liability for damages arising out of orders which had not been delivered within thirty-five days of the trade date. (R. 435B).

ARGUMENT

POINT I

THE COURT ERRED IN DENYING FIRST EQUITY'S MOTION FOR SUMMARY JUDGMENT AND IN GRANTING USU'S CROSS-MOTION FOR SUMMARY JUDGMENT BECAUSE USU HAD POWER TO INVEST FUNDS IN ITS POSSESSION IN SECURITIES OTHER THAN THOSE ENUMERATED IN SECTION 33-1-1, UTAH CODE ANNOTATED (1953).

A. Reason for Appeal.

The Court below granted USU's Cross-Motion on the ground that First Equity's claim was "barred by the provisions of the Utah Code prohibiting the investment by state employees of funds in their custody in securities other than those enumerated in Utah Code §33-1-1." (R. 435D). The Order of the Lower Court is in error because USU had the power to invest in common stock as part of its general power to control and supervise all appropriated and donated funds; to purchase, hold and sell all forms of personal property; to invest and manage such property; and to handle its own financial affairs.

B. Statutory Authority to Invest.

In 1888, an Agricultural College and an Experiment Station were created by the Territorial Legislature, and a governing

Board of Trustees was established with the following duties and powers:

> They shall have the general control and supervision of the agricultural college, the farm pertaining thereto, and such land as may be vested in the college by Territorial legislation, of all appropriations made by the Territory for the support of the same, and also of lands that may hereafter be donated by the Territory . . . or by any person or corporation, in trust for the promotion of agricultural and industrial pursuits . . . . [Emphasis added].

COMPILED LAWS OF UTAH §1855(1888).

The authority so granted to generally control and supervise all appropriations and private donations was clearly intended to invest the College with broad discretion in handling its financial affairs. This general authority to control and supervise lands and appropriations was perpetuated in 1895 by Article X, Section 4 of the Utah Constitution, which provides:

> The location and establishment by existing laws of the University of Utah, and the Agricultural College are hereby confirmed, and all the rights, immunities, franchises, and endowments heretofore granted or conferred, are hereby perpetuated unto said University and Agricultural College respectively.

The structure of USU was revised in 1929 by the Utah Legislature, changing its status to that of a "body politic and corporate", but the Legislature expressly perpetuated in the College "all rights, immunities, franchises and endowments"

theretofore "granted or conferred". The statute further provided that USU:

> . . . may have and use a corporate seal, may sue and be sued and contract and be contracted with. It may take, hold, lease, sell and convey real and personal property as the interests of the college may require. [Emphasis added].

5B U.C.A. §53-32-2.

The language here is extremely broad, with no indication that the "property" which may be taken, held, sold and conveyed is exclusive of common stock. Section 53-32-4 of the same Act delineated the general corporate powers of USU with respect to the use of funds received by gift, grant, devise or bequest:

> The Utah State Agricultural College [Utah State University of Agriculture and Applied Science] in its corporate capacity may take by purchase, grant, gift, devise or bequest any property real or personal for the use of any department of the college and for any purpose appropriate to the objects of the college. It may convert property received by gift, grant, devise or bequest and not suitable for its uses into other property so available or into money. Such property so received or converted shall be held, invested and managed, and the proceeds thereof used by the board of trustees for the purposes and under the conditions prescribed in the grant or donation . . . . [Emphasis added].

5B U.C.A. §53-32-4.

In 1969, the Legislature reiterated the university's general power to control and manage its finances in the Higher Education

Act, 5B U.C.A. §53-48-1. et seq. That Act did not limit or narrow the university's existing general powers, but rather indicated a broad discretion in the management of all funds:

> Each university and college and the Utah Technical College at Provo and the Utah Technical College at Salt Lake City may do its own purchasing, issue its own payrolls, and handle its own financial affairs under the general supervision of the Board as provided in this act. [Emphasis added].

5B U.C.A. §53-48-10(5).

In addition, the 1969 Act specifies that:

> Any institution, college or department or its foundation or organization engaged in a program authorized by the board [of Higher Education] may:
>
> . . .
>
> (c) Accept contributions, grants or gifts from any private organization. . . .
>
> (d) Retain, accumulate, invest, commit and expend the funds and proceeds of such authorized programs . . . . [Emphasis added].

5B U.C.A. §53-48-20(3).

The power to invest was expressly and explicitly granted with respect to non-appropriated funds such as private contributions, grants or gifts. In addition, USU was expressly and explicitly empowered to take any form of personal property by purchase, to hold, and to sell that property as the interests of the college may require. These explicit powers and the other broad powers of

USU to manage, control, and supervise its financial affairs were established and perpetuated by early statutes and the Utah Constitution. They were recognized and continued by the 1969 Act, and were not abrogated until after the relevant events involved in this case were completed. See The State Money Management Act of 1974, U.C.A. §51-7-1 et seq. (1974 Interim Supplement).

C. Investment Activities of USU.

This Court has stated that legitimate sources of enlightenment as to legislative intent are the actions of those entities which have the responsibility of conforming to the statutory provision in question. State Board of Education v. State Board of Higher Education, 29 Utah 2d 110, 505 P.2d 1113 (1973). It is certainly true that USU and other Utah universities have had a long history of investing in common stock, which practice continued unchallenged until the events which precipitated this litigation. The governing bodies and officers of the university construed the existing statutory pattern as one permitting USU to invest in common stock. Indeed, it appears from the record that no question as to the propriety, let alone the legality, of common stock purchases arose until the University Investment Program began to show a substantial loss. (R. 212, 214). Even at the time questions were raised by the university and its accountants, an opinion from the Attorney General's office indicated that USU

was empowered, at least, to invest "funds derived from grants, gifts, devises or bequests in such securities or other property as it deems fit or as the donor may specify." (R. 157, at 5).

D. The Proper Interpretation of Section 33-1-1.

USU argued below that the explicit Legislative grants of power to purchase, hold and sell all forms of personal property, to convert private donations into other forms of property, and to invest such property, were insufficient to give USU the power to invest in common stock. (R. 366-68). By implication, USU argued and the Lower Court ruled that any actions relating to investment in common stock, carried out by the governing bodies and officers of the university after the enactment of Section 33-1-1 of the Utah Code in 1939, were all ultra vires.

It is only upon such an erroneous interpretation of existing statutory and constitutional language that USU is able to construct its primary theory that Section 33-1-1 is an enabling statute without which no power exists to invest any funds whatsoever in any form of securities. That is, until 1939, when the statute was passed, none of the persons or organizations listed in the statute could legally invest in any form of securities. USU's secondary theory appears to be that Section 33-1-1 is a prohibitory statute which restricts previously held powers of investment to the power to invest only in the securities listed in Section 33-1-1. The

Court below appears to have adopted this latter theory. (R. 435D).

Because the proper interpretation of this statute is so significant to this appeal, it is set forth in its entirety:

> Investments in certain securities declared lawful. On and after the passage of this act investment by receivers, insurance companies of whatever type or nature, building and loan associations, savings and loan associations and other financial institutions, charitable, educational, eleemosynary and public corporations and organizations, municipalities and other public corporations and bodies, mutual assessment insurance companies, mutual benevolent and benefit associations; or investment of funds of any state insurance fund, state sinking fund, state school fund, firemen's relief and pension fund, police pension fund, or other pension fund; or investment by any administrative department, board, commission or officer of the state government, and of any county government, authorized by law to make investments of funds in the custody or under the control of such department, board, commission, or officer, school district or township, or the investment by any private, political, or public instrumentality, body, corporation or person of their own funds or funds in their possession in bonds and other obligations of or bonds or obligations guaranteed as to interest and principal by the United States; bonds or debentures issued by any federal home loan bank in accordance with the provisions of the Federal Home Loan Bank Act as now or hereafter amended; consolidated federal home loan bank bonds or debentures issued by the Federal Home Loan Bank Board in accordance with the provisions of the Federal Home Loan Bank Act as now or hereafter amended; farm loan bonds, consolidated farm loan bonds, debentures, consolidated deben-

> tures and other obligations issued by federal land banks and federal intermediate credit banks under the authority of the Federal Farm Loan Act approved July 17, 1916, as now or hereafter amended (Title 12, U.S.C. Sections 636-1012 and sections 1021-1129), and the bonds, debentures, consolidated debentures and other obligations issued by banks for co-operatives under the authority of the Farm Credit Act of 1933, as now or hereafter amended (Title 12 U.S.C., Sections 1131-1138f); bonds or debentures issued by the federal savings and loan insurance corporation in accordance with the provisions of Title IV of the National Housing Act as now or hereafter amended; in shares or accounts of building and loan associations which have been insured by the federal savings and loan insurance corporation and shares or accounts of federal savings and loan associations incorporated under the provisions of the Home Owners' Loan Act of 1933 as now or hereafter amended; which have been insured by the federal savings and loan insurance corporation to the extent to which the withdrawal or repurchasable value of such shares or accounts now are or may hereafter be insured by the federal savings and loan insurance corporation under the Acts of Congress of the United States of America now in effect or which may hereafter be enacted, shall be lawful. [Emphasis added].

4A U.C.A. §33-1-1.

The following significant points about this section must be emphasized. First, the statute consists of one declaratory sentence, the basic structure of which is as follows: "[I]nvestment by [named parties] of their own funds or funds in their possession in [specified securities] shall be lawful." USU's

interpretation of the statute is the negative implication of this declaration, to wit: "Investment by the named parties of their own funds or funds in their possession in other than specified securities shall be unlawful."

Second, the statute expressly refers to "any private, political or public . . . corporation or person" and its provisions and meaning must be equally applied to private corporations and person. If it is to be construed as USU contended below, and as the Lower Court held, such persons would be prohibited thereby from investment of their funds in any but the enumerated securities. That such was the legislative intent of Section 33-1-1 is manifestly absurd.

Third, if Section 33-1-1 is to be regarded as an enabling statute, constituting the source of investment authority available to the university and other persons subject to its provisions, what is to be made of the express direction of the Legislature ten years earlier that USU's property "shall be held, invested and managed, and the proceeds thereof used by the board of trustees for the purposes and under the conditions prescribed"? See 5B U.C.A. §53-32-4. USU's theory makes the 1929 legislative mandate mere surplusage.

Fourth, the statute itself refers to "investment by any . . .

board . . . or officer of the state government, authorized by law to make investments of funds in the custody or under the control of such . . . board . . . or officer . . . ." This wording contemplates other authorizing or enabling laws and regulations; it does not authorize USU's board of trustees to make investments through legally appointed officers, it merely recognizes that certain state boards and officers have such authority. Section 33-1-1 does not create new powers.

Fifth, it must be considered whether Section 33-1-1 is a prohibitory statute, one which limits previously authorized investment powers. The Lower Court adopted this interpretation. (R. 435D). Such an interpretation is, of course, based upon the premise that such powers have been previously granted. The statute is noticeably free from specific prohibitive language such as would be necessary to terminate previously existing powers. Furthermore, the prohibition would have to apply to private persons and corporations as well as to USU and it is clear that investments by private persons in securities other than those listed in Section 33-1-1 have not been prohibited or declared unlawful by the Utah Legislature. To argue that Section 33-1-1 is a prohibitory statute is, again, manifestly absurd.

The proper interpretation of Section 33-1-1 is very simple. Without prohibiting any other investments or requiring only the

listed investments, the Legislature declared that certain investments were lawful. As Section 33-1-3 states, "The provisions of this act [including Section 33-1-1] are supplemental to any and all other laws relating to and declaring what shall be legal investments . . . ." Lists of legal investments "tend to give help to trustees in selecting investments and work in the direction of certainty as to investment duties". G. BOGURT, HANDBOOK OF THE LAW OF TRUSTS 420 (3d ed. 1952). A trustee, such as a "University money manager" administering the monies placed in his custody, who buys securities on the legal list will "in all probability be protected against any claim of breach of trust; but following the legal list does not absolutely insure protection to the trustee against liability." Id. A trustee must always use reasonable care in following a list of legal investments. Id., at 421.

E. Proper Governance of State Investments.

The major argument raised by USU against this straight-forward interpretation of Section 33-1-1 is that it leads to a situation in which funds in the university's custody could be invested in "anything", including speculative securities. That argument, of course, ignores the strict duties and obligations imposed upon public officers by the common law. See generally 63 Am Jur 2d, Public Officers and Employees, §§ 328-29. Nevertheless, it must be acknowledged that the concern is legitimate in light of the

broad investment powers, as to both appropriated and non-appropriated funds, which were possessed by the university.

In State of Utah v. duPont Walston, Inc., [Current Binder] CCH FED. SEC. L. REP. ¶94,812 (D. Utah, October 1, 1974), Judge Anderson commented on this very problem:

> The court has serious concerns with plaintiffs' theory that the University does not have power to invest in common stocks for it does not appear that the Utah Code Ann. §33-1-1 (1966) is an enabling statute which clearly sets forth the investment guidelines for state universities. The court is equally concerned with . . . the theory that would give state universities a free hand in all investment matters.

Id., at 96,716.

An identical concern on the part of the Utah Legislature is evidenced by its passage of the State Money Management Act of 1974, U.C.A. §51-7-1 et seq. (1974 Interim Supplement), which for the very first time establishes legislative limits to the university's discretion. Several of that Act's provisions make it clear that Section 33-1-1 is not to be construed as USU argued below. The Act's purposes were set forth as follows:

> Purpose of act. (1) The purpose of this act is to secure the maximum public benefit from the deposit and investment of public funds, and, in furtherance of such purpose:
>
> (a) To safeguard and protect deposits of public funds by providing qualifications for depositories of these funds;

(b) To establish and maintain a continuing statewide policy for the deposit and investment of public funds;

(c) To establish a system of centralized investment for state money and to authorize public treasurers to invest public funds either under the state policy or through centralized state management of pooled investment funds; and

(d) To establish minimum requirements for bonding of public treasurers.

(2) The legislature finds that the objectives of this act will best be obtained through improved money management, emphasizing the primary requirements of safety and liquidity and recognizing the different investment objectives of operating and permanent funds and the importance of investing public funds within the state so as to promote the economic welfare of the entire state.

If, as was argued below, the Legislature had enacted a continuing statewide investment policy through Section 33-1-1, the Legislature had no need to "establish" such a policy in 1974. It is clear that the Legislature did not regard Section 33-1-1 as being in any sense prohibitive or comprehensive in its application to the public funds, the disposition of which the Legislature undertook to regulate and circumscribe in the 1974 Act. If Section 33-1-1 had been regarded as an enabling or prohibitive statute, its repeal would have been necessary, as was the repeal of a number of other regulatory sections. Section 33-1-1 has not been repealed. See Repealing Clause, State Money Management Act of 1974, LAWS 1974,

ch. 27, §39. The legal list contained in Section 33-1-1 has been declared no longer applicable to investments of public funds, U.C.A. §51-7-21 (1974 Interim Supplement), but it has been replaced by more comprehensive legal lists, U.C.A. §§ 51-7-11 and 12 (1974 Interim Supplement), by a "prudent man" rule applicable to investments of certian non-appropriated funds of member institutions of the state system of higher education, U.C.A. §51-7-14 (1974 Interim Supplement), and by a five part list of criteria to be used by all public treasurers in making deposits and investments of all public funds. U.C.A. §51-7-17 (1974 Interim Supplement). Interestingly, funds acquired by gift, devise, or bequest or private grant may still be invested in common stock, although the Legislature has specified criteria to be used in determining the kinds of private corporations in which the university may invest. U.C.A. §§51-7-12 and 13 (1974 Interim Supplement). All these additions to Utah statutory law make clear the fact that Section 33-1-1 was enacted as a legal list to declare presumptively legal investments for persons entrusted with investment responsibilities.

First Equity is in agreement with the point made by USU before the Court below, that the university is "subject to the control of the Legislature", (R. 367), and First Equity does not contend that Article X, Section 4 of the Utah Constitution places

the university outside that control. First Equity argues, however, that at the time of the transactions in question, legislative control expressly allowed the purchase of common stock with funds in the university's custody. Public officers purchased such securities at the risk of having to indemnify the public, but they were authorized to so invest the funds in their custody. Appellant urges, furthermore, that the concern referred to above has its proper forum in the Legislature, where it appears to have been heard, and that it does not at this time constitute an appropriate argument before this Court.

The issue before this Court is whether the above delineated statutory scheme permitted USU, at the time of the transactions involved in this litigation, to purchase common stock, with either public or non-appropriated funds. A determination that either alternative is possible under the statutes involved will require that the Order below granting USU's Cross-Motion for Summary Judgment be reversed.

POINT II

THE COURT ERRED IN GRANTING USU'S CROSS-MOTION FOR SUMMARY JUDGMENT BECAUSE THE COURT DETERMINED THAT USU HAD POWER TO INVEST FUNDS RECEIVED FROM INDIVIDUAL GRANTS OR DEVELOPMENT CONTRACTS.

A. Reasons for Appeal.

The Memorandum Decision of the Court below states equivocally that Section 33-1-1 bars USU's investment of funds in its custody

in common stock, "with the possible exception of funds received by the institution from individual grants or development contracts". (R. 258). Thus, in denying First Equity's motion, the Lower Court stated that there was

> a triable issue of fact whether USU, at the time Catron ordered the stock in question or the time payment for said stock fell due, had funds which it had received from individual grants or development contracts sufficient to pay for part or all of said stock . . . .

(R. 435B).

The Court below could have determined that a triable issue of fact existed only if it had first determined that certain non-appropriated funds could lawfully be invested in common stock. Therefore, Appellant submits that the Lower Court erred in granting USU's Cross-Motion on the basis that no funds in the custody of the university could be invested in common stock.

B. Authority to Invest Non-Appropriated Funds.

In 1929 and again in 1969, the Utah Legislature explicitly stated that USU could invest funds received as contributions, grants, gifts, devises, or bequests. See 5B U.C.A. §§ 53-32-4 and 53-48-20(3) (quoted above in relevant part). On December 15, 1972, the office of the Attorney General issued an opinion letter to the State Auditor informing him that USU had authority "to invest funds derived from grants, gifts, devises or bequests

in such securities or other property as it deems fit or as the donor may specify." [Emphasis added]. (R. 157, at 5). At the time of the transactions involved in this litigation, USU allegedly was operating or was supposed to be operating on the basis of that opinion. (R. 215-17).

C. Contradictory Orders Below.

In granting USU's Cross-Motion for Summary Judgment, the Court below stated that First Equity's claim was "barred by the provisions of the Utah Code prohibiting the investment by state employees of funds in their custody in securities other than those enumerated in Utah Code §33-1-1." (R. 435D). The obvious meaning of this Order is that no funds in the custody of USU may be invested in common stock. The Lower Court also concluded that certain non-appropriated funds could be invested in common stock, based upon Sections 53-48-10(5) and 53-48-20(3) of the Utah Code. (R. 258). Appellant agrees entirely with that portion of the Lower Court's decision which concludes that USU had the power to invest non-appropriated funds; however, appellant disagrees with the way the Lower Court ignored that part of its own conclusion in granting USU's Cross-Motion for Summary Judgment. Therefore, First Equity petitions this Court to affirm the conclusion of the Lower Court that non-appropriated funds in the custody of USU could have been invested in common stock and to

reverse the Order granting USU's Cross-Motion for Summary Judgment.

POINT III

THE COURT ERRED IN DENYING FIRST EQUITY'S MOTION FOR SUMMARY JUDGMENT BECAUSE NO TRIABLE ISSUE OF FACT WAS RAISED BY THE CONCLUSION THAT USU COULD INVEST FUNDS RECEIVED FROM INDIVIDUAL GRANTS OR DEVELOPMENT CONTRACTS.

A. Reason for Appeal.

The Lower Court denied First Equity's Motion for Summary Judgment because it concluded that an issue of fact was raised as to whether sufficient non-appropriated funds were available for USU to purchase the common stock. (R. 435B). First Equity contends that this conclusion is erroneous because whether such funds were available is not a relevant issue.

Whether or not USU had sufficient authorized funds to purchase the shares is irrelevant to the question of whether First Equity is entitled to compensation, unless the Court assumes that the agent of a governmental body is on constructive notice that his contract is ultra vires any time the governmental body does not have sufficient authorized funds to meet its contract obligations. Such a proposition is untenable.

B. First Equity was the Agent of USU.

The transactions involved in this litigation were unsolicited orders placed by USU with First Equity and First Equity's duty was to purchase shares of stock, as a broker, for the account of USU

and to tender delivery of the certificates to USU. (R. 99-149, 160-62, 312-13). A broker has been defined as "[a]n agent employed to make bargains and contracts for compensation." [Emphasis added]. BLACK'S LAW DICTIONARY 241 (4th ed. 1951). Stock brokers have been defined as "[b]rokers employed to buy and sell for their principals stocks, bonds, government securities, etc." [Emphasis added]. Id., at 242. Article I, Section 3(a) of the By-Laws of the National Association of Securities Dealers states, in pertinent part, that a broker is "any individual, corporation . . . or other legal entity engaged in the business of effecting transactions in securities for the account of others . . . ." [Emphasis added]. See N.A.S.D. By-Laws, Art. I, §3(a) CCH N.A.S.D. MANUAL ¶1103. According to the Utah Uniform Commercial Code, 7B U.C.A. §70A-8-303, a broker is "a person engaged for all or part of his time in the business of buying and selling securities, who in the transaction concerned acts for, or buys a security from or sells a security to a customer." [Emphasis added]. Thus, in performing its contractual duties to purchase stock, First Equity was clearly the agent of USU.

C. Performance by First Equity.

USU, through its Assistant Vice President of Finance, entered into the five oral contracts involved in this litigation, under which First Equity was to purchase certain shares of common stock

and deliver them to USU. All five purchases were consummated and notice thereof was sent to USU. (R. 99-149, 160-62). First Equity did everything necessary to cause delivery to be made as USU had directed. On March 13, 1973, delivery of certificates representing 3,000 shares of Advanced Memory Systems was tendered to USU, but payment was refused. (R. 305, 307, 313). At approximately the same time, delivery was tendered to USU of sufficient shares to completely satisfy the other four outstanding orders. (R. 313, 342). On March 19, 1973, USU informed First Equity that the university would not accept delivery with respect to all five orders because Catron was not authorized to purchase common stock. (R. 196, 251). This repudiation of the five contracts was transmitted to First Equity approximately two weeks after USU had purchased, received, accepted and paid for $445,050 worth of Fashion Fabric's common stock through the services of First Equity.(R. 99-149, 160-62). Written confirmation of this decision by USU was given to First Equity's Salt Lake City attorney on March 22, 1973, by hand delivered letter from Assistant Attorney General Madsen. (R. 330-31).

D. First Equity's Right to Compensation.

An agent is entitled to his compensation when he completes his undertaking, even though his principal received no benefit therefrom. Curtis v. Mortensen, 1 Utah 2d 354, 267 P.2d 237 (1954); 3 Am Jur 2d, Agency §§ 247 et seq.; 12 Am Jur 2d, Brokers §§183,

199 et seq. First Equity's undertaking was based upon an oral contract to purchase certain shares and to tender delivery to USU. First Equity had purchased the shares in question and had tendered delivery or had done all that was required of it to accomplish delivery of the certificates to USU when USU repudiated the contracts. All of the actions which were to be undertaken by the personnel of First Equity had been completed. Therefore, First Equity is entitled to compensation, in the form of commissions, from USU, whether or not USU actually purchased the stock.

Under certain circumstances, an agent is also entitled to indemnity from his principal for the damages the agent suffers as a result of the performance of unlawful acts by the agent. In Horrabin v. Des Moines, 198 Iowa 549, 199 N.W. 988 (1924), the City of Des Moines employed Horrabin as its agent to build a bridge and agreed to furnish the necessary rights-of-way. Horrabin built the bridge where the City had directed, but the City failed to obtain a necessary right-of-way. The property owner brought an action of trespass against the City and Horrabin and recovered against Horrabin. Horrabin then sought to have the City indemnify him for losses suffered as a result of the trespass he had committed as the agent of the City. The court held that since the actions of Horrabin were not manifestly illegal, and were done in the execution of his agency, the City should be required to indemni-

fy him for losses suffered by reason of the trespass action.

The Utah Supreme Court adopted the same principle in Hoggan v. Cahoon, 26 Utah 444, 73 P. 512 (1903) in which the Court quoted Moore v. Appleton, 26 Ala. 633, 638-39 (1855), to the effect that indemnity will be allowed between an agent and his principal:

> where the act of the agent was not manifestly illegal in itself, and was done bona fide in the execution of his agency, and without knowledge (either actual or implied by law) that it was illegal . . . .

26 Utah at 450, 73 P. at 514.

The actions of First Equity were clearly "done bona fide in the execution" of the oral brokerage contract. The purchase of common stock by First Equity on behalf of USU "was not manifestly illegal in itself" because USU had been purchasing common stock for some time and even the Attorney General's office had concluded that investment in common stock was not necessarily illegal. (R. 157, at 5). Actual knowledge that USU had revoked Catron's power to authorize Appellant to purchase common stock, if such had in fact occurred, was not transmitted to First Equity until after First Equity had performed its contractual duties. Constructive knowledge that Catron had no authority cannot be implied by law to First Equity because, according to the opinion letter issued by the office of the Attorney General, Catron did have limited authori-

ty to invest in common stock. Furthermore, USU had just completed a purchase of over $400,000 worth of common stock through First Equity. Therefore, First Equity is entitled to be indemnified by USU for losses it suffered in the resale of the shares of Advanced Memory Systems.

E. Constructive Knowledge of Insufficient Funds.

The factual issue of whether sufficient non-appropriated funds were available is not relevant to any of the foregoing propositions, unless First Equity can be held to have had constructive notice that the purchase contracts were ultra vires because no authorized funds were available. The Court below appears to have held just that.

Practically, the burden imposed by such a ruling upon all transactions between governmental entities and their private agents would be insurmountable. The agent would have to obtain some form of a guarantee that the funds would be available when he had performed his part of the contract, such as having the money placed in an escrow account. Otherwise, the governmental entity could turn its back on the contract, as it has done in this case, and claim "Ultra vires!" by reason of insufficient funds. The Utah Supreme Court has clearly not adopted any ruling which would uphold such a position.

In Baker Lumber Co. v. A.A. Clark Co., 53 Utah 336, 178 P. 764

(1919), a school district had contracted with an agent to build a high school. Sufficient funds to pay for the high school were not available when the school was built; so, the school district issued interest-bearing warrants payable on demand and at a specified time. The issuance of such warrants was not authorized by statute and the interest payments were later disputed. The Court stated:

> There is no express provision in the statutes of this state authorizing school boards or other public corporations to issue interest-bearing warrants. There is a provision relating to interest on school bonds issued after authority obtained from the qualified electors of the several school districts, and the rate of interest for such indebtedness is that the bonds so issued shall bear interest not exceeding five per cent per annum, payable annually or semi-annually. Manifestly that provision of the statute does not relate to and does not govern where the facts are as in this case. It is further contended that the great weight of authority, in the absence of express statutory provisions, is that warrants issued by public corporations do not bear interest.
>
> . . .
>
> In this action, as indicated, the debt was due at the time the building was accepted. The school board was authorized to contract to pay the debt at that date. We are unable to understand why a public corporation should not be required to meet its obligations the same as any other body authorized to contract debts, and upon a failure to make payments at the time agreed why it should not be required to pay interest for any forbearance as an individual. [Emphasis added].

53 Utah at 350; 178 P. at 770.

Appellant urges this Court to find that the Lower Court erred in holding that the amount of non-appropriated funds available to USU for the purchase of common stock was a relevant issue of fact.

POINT IV

THE COURT ERRED IN DENYING FIRST EQUITY'S MOTION FOR SUMMARY JUDGMENT BECAUSE A TECHNICAL VIOLATION OF THE 35-DAY MARGIN REQUIREMENT OF REGULATION T DOES NOT CONSTITUTE A COMPLETE DEFENSE TO FIRST EQUITY'S CLAIM FOR DAMAGES.

A. Reason for Appeal.

First Equity's failure to deliver the order of Advanced Memory Systems shares to USU within thirty-five days from the date Catron placed the order constituted a technical violation of Regulation T, 12 C.F.R. Part 220, promulgated by the Federal Reserve Board. According to the Lower Court, this violation constitutes a complete defense to First Equity's damage action based upon those orders. (R. 435B). The Lower Court reached this conclusion by finding that Avery v. Merrill, Lynch, Pierce, Fenner & Smith, 328 F. Supp. 677 (D.D.C. 1971), represented "a proper ruling" on the question. (R. 259). Appellant submits that the conclusion of the Court below is in error because: (1) Avery was not good law at the time it was decided; (2) prior to the decision below, Congress had effectively overruled Avery; and (3) the appellate courts which have considered the question of an affirmative defense based upon Regulation T have unanimously ruled that a technical violation of

Regulation T does not constitute a complete defense to a broker's action for damages.

B. Statutory Background.

Section 7 of the Securities Exchange Act of 1934 (the "Exchange Act"), 15 U.S.C. §78g, provides in part:

> (a) For the purpose of preventing the excessive use of credit for the purchase or carrying of securities, the Board of Governors of the Federal Reserve System shall, prior to the effective date of this section and from time to time thereafter, prescribe rules and regulations with respect to the amount of credit that may be initially extended and subsequently maintained on any security (other than an exempted security).
>
> . . .
>
> Such rules and regulations may make appropriate provision with respect to the carrying of . . . special or different margin requirements for delayed deliveries . . . .

The primary legislative purpose for this section of the Exchange Act "is to give a Government credit agency an effective method of reducing the aggregate amount of the nation's credit resources which can be diverted . . . into the stock market". H.R. REP. NO. 1383, 73d Cong., 2d Sess. 8 (1934). Congress also recognized that a by-product of the main purpose would be protection of "the small speculator by making it impossible for him to spread himself too thinly." [Emphasis added]. Id.

Section 7 of the Exchange Act also provided:

> (c) It shall be unlawful for any member of a national securities exchange or any broker or dealer, directly or indirectly, to extend or maintain credit . . .
>
> (1) on any security . . . in contravention of the rules and regulations which the Board of Governors of the Federal Reserve System shall prescribe . . . .

Violations of the rules and regulations promulgated by the Federal Reserve Board subject a broker to disciplinary action by the Securities and Exchange Commission. See 15 U.S.C. §78o-3(e)(2); Strathmore Sec., Inc. [1964-66 Transfer Binder] CCH FED. SEC. L. REP. ¶77,426 (S.E.C. 1966).

Pursuant to its statutory authority, the Federal Reserve Board issued Regulation T, which states in relevant part:

> General Rule (a)(1) Pursuant to this section, a creditor may establish for any customer one or more special accounts.
>
> . . .
>
> (c)(1) In a special cash account, a creditor may effect for or with any customer bona fide cash transactions in securities in which the creditor may:
>
> > (i) Purchase any security for, or sell any security to any customer, provided . . . the purchase or sale is in reliance upon an agreement accepted by the creditor in good faith that the customer will promptly make full cash payment for the security and that the customer does not contemplate selling the security prior to making such payment.
>
> . . .

> (2) In case a customer purchases a security . . . in the special cash account and does not make full cash payment for the security within 7 days after the date on which the security is so purchased, the creditor shall, except as provided in subparagraphs (3)-(7) of this paragraph, promptly cancel or otherwise liquidate the transaction or the unsettled portion thereof.
>
> . . .
>
> (5) If the creditor, acting in good faith in accordance with subparagraph (1) of this paragraph, purchases a security for a customer, or sells a security to a customer, with the understanding that he is to deliver the security promptly to the customer, and the full cash payment to be made against such delivery, the creditor may at his option treat the transaction as one to which the period applicable under subparagraph (2) of this paragraph is not the 7 days therein specified but 35 days after the date of such purchase or sale.

12 C.F.R. §220.4(a),(c).

Thus, a broker acting in good faith may purchase a security into a special cash account for a customer who has agreed to promptly make full cash payment for the security prior to selling the security. Under most circumstances, if the customer does not pay within seven days of the purchase date, the broker must liquidate the account. However, to protect the customer from the economic disadvantage of purchasing a large block of shares in a thin market, Regulation T provides that delivery of the block of shares and payment therefor can be extended over a thirty-five day period. If delivery and payment are not accomplished within the thirty-five

days, the account is to be liquidated. See generally, Effros, A Note on Regulation T, 82 BANKING L.J. 471 (1965).

Effective November 1, 1971, Section 7 of the Exchange Act was amended, resulting in a reapportionment of the burden of compliance with the margin rules. Subsection (f) of Section 7 now reads in pertinent part:

> (1) It is unlawful for any United States person . . . to obtain, receive, or enjoy the beneficial use of a loan or other extension of credit from any lender . . . for the purpose of (A) purchasing or carrying Unites States securities . . . if . . . the loan or other credit transaction is prohibited.

Also effective November 1, 1971, the Federal Reserve Board issued Regulation X, 12 C.F.R. Part 224, which sets forth the rules governing investors who obtain credit in securities transactions. The relevant parts of Section 224.2(a) of Regulation X state:

> A borrower shall not obtain any purpose credit [i.e., credit for the purpose of purchasing or carrying securities] . . . unless he does so in compliance with the following conditions:
>
> . . .
>
> (2) Credit obtained from a broker/dealer shall conform to the provisions of Part 220 (Regulation T), which is hereby incorporated in this part (Regulation X). When the term "broker/dealer"is used in this part (Regulation X), it means a person who is a broker or dealer, including every member of a national securities exchange, and includes a foreign branch or subsidiary of a broker/dealer.

Lastly, Section 29 of the Exchange Act, 15 U.S.C. §78cc, states in pertinent part:

> (b) Every contract made in violation of any provision of this title or of any rule or regulation thereunder, and every contract (including any contract for listing a security on an exchange) heretofore or hereafter made the performance of which involves the violation of, or the continuance of any relationship or practice in violation of, any provision of this title or any rule or regulation thereunder, shall be void (1) as regards the rights of any person who, in violation of any such provision, rule, or regulation, shall have made or engaged in the performance of any such contract, and (2) as regards the rights of any person who, not being a party to such contract, shall have acquired any right thereunder with actual knowledge of the facts by reason of which the making or performance of such contract was in violation of any such provision, rule, or regulation . . . .

Thus, on the face of the statute, a contract "made in violation of" or "the performance of which constitutes the violation of" Regulation T or Regulation X appears to be completely void. The courts, however, have refused to interpret Section 29(b) so broadly.

C. Court Interpretations of Section 29(b).

Courts have dealt with Section 29(b) in two pertinent contexts: (1) where a borrower brings a damage action to recover losses sustained by reason of the lender's violation of federal margin requirements; and (2) where a lender sues the borrower for losses and the borrower asserts a violation of federal margin requirements as a complete defense.

Prior to the enactment of Section 7(f) and the issuance of Regulation X thereunder, the majority of courts deciding the scope of Section 29(b), when the plaintiff borrower sought rescission of the contract, held that contracts subject to that section were not void but voidable. See Gordon v. duPont, Glore, Forgan, Inc. 487 F. 2d 1250 (5th Cir. 1973); Greater Iowa Corp. v. McLendon, 378 F.2d 783 (8th Cir. 1967); Royal Air Properties, Inc. v. Smith, 312 F.2d 210 (9th Cir. 1962); Goldman v. Bank of the Commonwealth, 332 F. Supp. 699 (E.D. Mich. 1971), aff'd, 467 F.2d 439 (6th Cir. 1972); Aubin v. H. Hentz & Co., 303 F. Supp. 1119 (S.D. Fla. 1969); Serzysko v. Chase Manhattan Bank, 290 F. Supp. 74 (S.D.N.Y. 1968), aff'd per curiam, 409 F.2d 1360 (2d Cir. 1969); Moscarelli v. Stamm, 288 F. Supp. 453 (E.D.N.Y. 1968); J. Cliff Rahel & Co. v. Roper, 186 Neb. 34, 180 N.W. 2d 682 (1970). This interpretation received Supreme Court approval in a case involving the violation of proxy rules, Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970). The Court concluded that a contract should be set aside under Section 29(b) "only if a court of equity concludes, from all the circumstances, that it would be equitable to do so." 396 U.S. at 388.

Shortly after the Mills decision, the Second Circuit Court of Appeals appeared to hold that a technical violation of Regulation T resulted in the contract being void rather than voidable under Section 29(b) despite the equities of the case. Pearlstein v.

Scudder & German, 429 F.2d 1136 (2d Cir. 1970). However, the court also noted that the investor did not contest his liability for the original contract price nor his liability for losses incurred prior to the time-limit violation. 429 F.2d at 1141 n.9. Thus, the decision only applied to the question of contract damages suffered after the Regulation T violation. In spite of this major limitation on the Pearlstein conclusion, the court in Avery v. Merrill, Lynch, Pierce, Fenner & Smith, 328 F. Supp. 677 (D.D.C. 1971), cited Pearlstein as authority for the proposition that a Regulation T violation by a broker automatically voids a sales contract under Section 29(b), thereby making the broker liable for all damages suffered by an investor. Since Avery was relied upon by the Court below, it will be discussed in detail.

In Avery, a broker sold some stock short for a sophisticated investor, but the investor did not have sufficient funds in her account to meet the margin requirements of Regulation T. During the following two weeks, the broker diligently attempted to obtain the additional monies from the investor and, failing to do so, the broker liquidated the investor's short position at a loss to her of over $8,000. She then sued the broker to have the entire transaction declared null and void and rescinded under Section 29(b) because the broker violated the seven-day margin limit set by Regulation T. The court found, as had a majority in Pearlstein,

that Congress had placed the onus of compliance with the margin requirements on brokers, and not on their customers. 328 F. Supp. at 680, citing Pearlstein, 429 F.2d at 1141. Since Congress had placed the ultimate responsibility with brokers, the court refused to shift that burden to the customer and the transaction was held to be null and void under Section 29(b). 328 F. Supp. at 680-81. Nevertheless, the court expressed dissatisfaction with the result:

> The Court deplores this type of alleged investor behavior and were not the mandate of Congress so unequivocal and the public policy considerations to strong, the Court might reach a substantially different decision than the one it does.

328 F. Supp. at 681.

Although Pearlstein can be interpreted as consistent with previous cases in light of the equitable apportionment of damages which it accomplished, the result in Avery imposed all the damages on the broker and did not take into account any defenses based upon comparative fault or participatory behavior on the part of the investor. Thus, Avery stands for a theory of strict liability for violations of Regulation T.

Section 7(f) and Regulation X became effective shortly after the decision in Avery. Since that case turned entirely on the fact that Congress had placed the onus of compliance solely on brokers,

it seems clear that the decision has been effectively overruled. Investors are now equally responsible for compliance.

In Bell v. J.D. Winer & Co., Inc., ___ F. Supp. ___ [Current Binder] CCH FED. SEC. L. REP. ¶95,002 (S.D.N.Y. Mar. 5, 1975), the investors brought action against the broker for a minor margin infraction that occurred long before the securities declined in value. The court noted that Section 7(f) and Regulation X undermine the approach to Section 29(b) taken by Pearlstein, and held that a de minimis violation of Regulation T does not always support a borrower's implied right of action. Thus, the court not only refused to utilize a strict liability theory in connection with Section 29(b), but granted summary judgment in favor of the defendants because plaintiffs had alleged no claim upon which relief could be granted. It is clear that the strict liability theory of Avery is not good law.

To date, counsel for First Equity have found only three cases of record wherein courts have been required to interpret Section 29(b) in the context of the customer asserting a broker's Regulation T violation as a defense. All three cases were decided prior to the effective date of Section 7(f) and Regulation X.

In Staley v. Salvesen, 35 Pa.D. & C. 2d 318 (C.C. Phila. 1963), a broker brought an action in assumpsit against his customer because the broker had suffered a loss when the customer's special cash —

account was liquidated. The customer claimed that the broker's violation of Regulation T was a complete defense and the trial court ruled that the broker's violation automatically voided the contract under Section 29(b). The case was not appealed.

Billings Associates, Inc. v. Bashaw, 27 App. Div. 2d 124, 276 N.Y.S. 2d 446 (4th Dep't 1967), involved a purchase of stock by a broker pursuant to the investor's oral stock purchase order. The customer failed to pay within the seven-day period prescribed by Regulation T and the broker waited nearly one month before liquidating the account. The broker's suit to recover the liquidation deficiency was dismissed by the trial court, but the appellate court reversed, holding that Section 29(b) only voids those contracts which by their terms actually violate the Exchange Act and Regulation T. The court stated that the broker was entitled to damages based upon the investor's breach, but it refused to allow the broker to benefit by its violation of Regulation T. Therefore, damages were limited to the difference between the purchase price of the shares and the highest market price between the date the account should have been liquidated and the date of sale by the broker. (Significantly, Pearlstein cites Billings Associates with approval when it discusses the question of the equitable apportionment of damages. See 429 F.2d at 1141 n.9.)

The second appellate decision which interpreted Section 29(b)

in the context of a Regulation T defense was Gregory-Massari, Inc. v. Purkitt, 1 Cal.App. 3d 968, 82 Cal. Rptr. 210 (1969). The facts were the same as in the other two cases and the broker sued to recover the liquidation deficiency. The broker relied on Billings Associates and the investor relied on Staley; the court agreed with the interpretation given to Section 29(b) in Billings Associates and pointed out that the trial judge in Staley erroneously ruled on the bases of her paraphrase of Section 29(b). The measure of damages adopted by the court was the same as that adopted in Billings Associates and Pearlstein.

Thus, it appears clear that the decision of the Lower Court, to the effect that a Regulation T violation constitutes a complete defense to an action for damages, is erroneous. The oral contracts entered into between First Equity and USU did not by their terms actually violate Regulation T and, therefore, Appellant petitions the Court to find that the Lower Court erred in denying Appellant's Motion for Summary Judgment on this ground.

D. Limitation on Damages.

Pearlstein, Gregory-Massari, and Billings Associates apportioned losses between the broker and the investor. Basically, any losses incurred prior to the violation of Regulation T were to be borne by the investor and any losses suffered as a result of the Regulation T violation were to be borne by the broker. This ruling was brought

to the attention of the Lower Court and First Equity stipulated to reduce the damages sought on its Motion for Summary Judgment accordingly. (R. 424-25). Thus, First Equity's claim for damages as a result of losses on the resale of the Advanced Memory Systems stock has been reduced from $37,045.27 to $15,625.00 and First Equity will suffer a non-recoverable loss of $21,420.27 as a result of its violation of Regulation T. USU does not dispute the figures used by Appellant to arrive at the aforementioned amounts. (R. 443).

CONCLUSION

The Summary Judgment of the Lower Court cannot be justified unless this Court were to hold:

1. That the explicit Legislative grants of power to USU to purchase, hold and sell all forms of personal property, to convert private donations into other forms of property, and to invest such property were wholly insufficient to give USU the power to invest in common stock, or

2. That even though USU may have been granted power to invest in common stock, the enactment of Section 33-1-1 of the Utah Code, in 1939, thereafter prohibited USU and any other private corporation or person from investing lawfully in common stock, or

3. That notwithstanding the fact that USU was authorized to invest certain non-appropriated funds in its custody in common stock, the Lower Court could ignore this in granting Summary Judgment in favor of USU.

The denial of First Equity's Motion for Summary Judgment cannot be justified unless this Court were to hold:

1. That the agent of a governmental entity is on constructive notice that his contract is ultra vires any time that the entity does not have sufficient authorized funds to meet its contract obligations, or

2. That a sophisticated institutional investor may absolutely avoid a contract with its broker whenever that broker inadvertantly violates the time-limit requirements of Regulation T, notwithstanding the fact that the investor utilized the particular broker so as to obtain cash-flow benefits resulting from the delays inherent in dealing with a broker over 2,000 miles away.

Appellant contends that the bases of the Lower Court's rulings are not sound and that the Orders should be reversed.

Respectfully submitted,

JOHNSON & SPACKMAN

By: Norman S. Johnson

Randall P. Spackman

Christine M. Durham
Attorneys for Appellant